Driehaus Small Cap Value Strategy

Appeasement. Does it ever solve our problems? Whether Neville Chamberlain's infamous "Peace for our time" (World War II started less than a year later) or giving your child a piece of candy (this typically buys you about two minutes), appeasement is generally not an effective long-term solution, and often ends in tears…or worse.

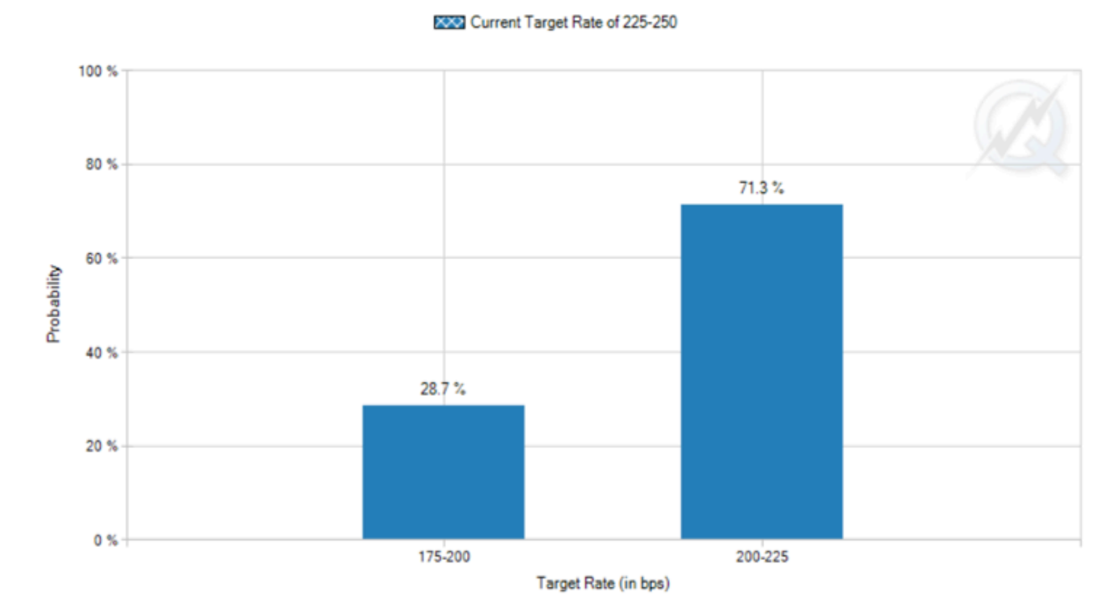
Source: history.com

Source: Eagleston Family Archives

Source: Wikipedia

Which brings us to Fed Chair Jerome Powell, who, after the President tweeted about an undervalued dollar and the Fed interest rate being too high, seems to be headed down the path of appeasement.

Exhibit 1:
Target Rate Probabilities for July 31st 2019 Fed Meeting



TARGET RATE (BPS)	PROBABILITY(%)			
	NOW *	1 DAY 3 JUL 2019	1 WEEK 27 JUN 2019	1 MONTH 4 JUN 2019
175-200	28.7%	29.2%	28.1%	14.3%
200-225	71.3%	70.8%	71.9%	51.7%
225-250 (Current)	0.0%	0.0%	0.0%	33.9%

Source: CME Group
*Data as of 4 Jul 2019 10:24:30 CT

Much like the world breathed a sigh of relief after Chamberlain waived a treaty in the air, or a parent enjoys a few moments of calm after feeding a toddler a treat, equity markets have certainly enjoyed the respite provided by Powell's seemingly newfound policy of appeasement. The S&P 500 has made a series of new highs, fueled by both the prospect of lower rates and de-escalation on the trade front, which could be seen as another case of appeasement. Small caps, as measured by the Russell 2000, have not yet regained their prior highs, and continue to trail large caps; over the last 12 months, small caps have trailed large by over 1300 basis points. This has put large caps in rarified air in terms of relative valuations versus small and, according to Jefferies, tilts the odds in favor of small caps going forward.

Growth's outperformance has been like a blitzkrieg; widespread and overwhelming. This has put valuations between the two at extremes, especially in small cap. After the recent Russell reconstitution, the growth index is even more chock full of non-earners, at least in small cap, where 33% of the weight and 43% of the companies are non-earners; value is 17% and 29%, respectively.

Exhibit 2:
Growth vs Value

2Q 2019	Value	Blend	Growth
Large	3.8%	4.3%	4.6%
Mid	3.2%	4.1%	5.4%
Small	1.4%	2.1%	2.7%

YTD	Value	Blend	Growth
Large	16.2%	18.5%	21.5%
Mid	18.0%	21.3%	26.1%
Small	13.5%	17.0%	20.4%

Source: JP Morgan

We've summarized what worked and what did not work within the Russell 2000 Index for the second quarter in WW II style; Axis are the losers, while Allies are the winners.

Exhibit 3:
Second Quarter Winners and Losers

Axis (Losers)	Allies (Winners)
Microcap	Larger Cap
Lowest ROE	Highest ROE
Energy	Industrials
Value	Growth
Non-earners	Low Yield
Poor Sales Growth	Lower Leverage
	Active Managers

Exhibit 4:
Year-to-date Winners and Losers

Axis (Losers)	Allies (Winners)
Microcap	Larger Cap
High Yield	Non-earners
Staples	Info Tech
Value	Growth
Poor Sales Growth	High Sales Growth
	Non- Dividend Payers
	High P/E

Source: Driehaus, Bloomberg and Jefferies

After a long struggle, the quality flag was finally raised in the second quarter. Larger cap, higher return on equity (ROE), and lower leverage were all generally rewarded in the second quarter. However, on a year-to-date basis, it has generally been the converse. Value continued to struggle, with the lowest price to earnings ratio (P/E) lagging, while the highest P/E's outperformed. Non-earners were the worst performers in the second quarter but remained the best year-to-date. Dividends were strange in the second quarter, with low yield doing well while high yield and non-payers lagged. Year-to-date, non-payers have outperformed while high yielders have underperformed. Perhaps no factor has been as impactful as old-fashioned sales growth. Specifically, companies with the worst growth have been treated as rudely as the Germans at Stalingrad.

From a sector perspective, energy was the worst performer in the second quarter, down almost 9% in the Russell 2000 Index. Industrials, a typical overweight for active managers, was the best sector, up over 8%. Financials finally found some relief, gaining over 5%, while investors sought safety in utilities which, despite high valuations, gained over 5%.

We active managers have felt as isolated as the Brits at Dunkirk, besieged but hoping there might be help just over the horizon. The second quarter felt like we saw some ships in the distance (at least in terms of relative performance), with more than half of small cap managers outperforming in growth, core, and value. Our growth friends added the most alpha for both the quarter and year to date, while core and value have not fared as well.

Exhibit 5:
Small Cap Managers Core – Growth - Value

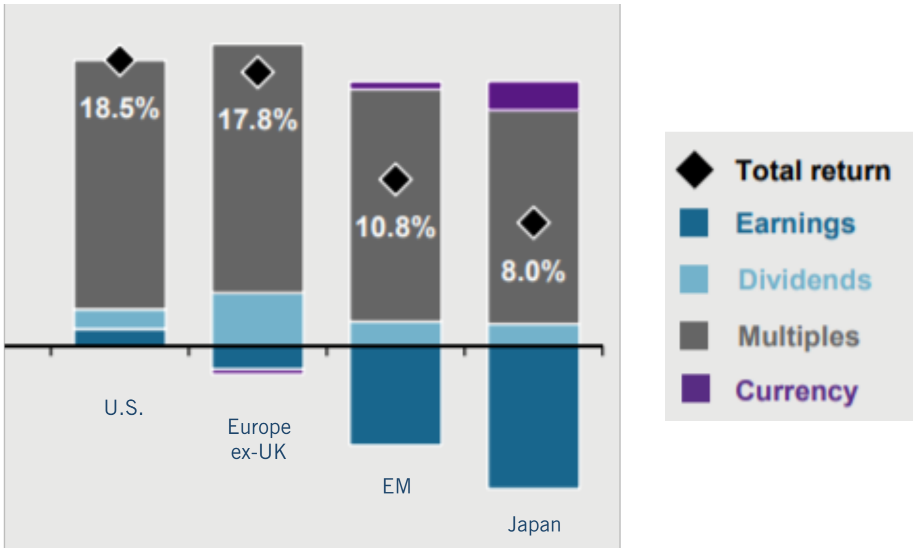
Small-Cap Managers

	Core				Growth				Value			
	% Beat	Avg Ret	Bench	Alpha	% Beat	Avg Ret	Bench	Alpha	% Beat	Avg Ret	Bench	Alpha
June	46.9	6.9	7.1	-0.1	38.2	7.2	7.7	-0.5	70.5	7.0	6.4	0.6
Q2	53.4	2.4	2.1	0.3	73.9	4.7	2.7	2.0	55.6	1.3	1.4	-0.1
YTD	**40.0**	**16.3**	**17.0**	**-0.7**	**70.5**	**23.8**	**20.4**	**3.5**	**58.5**	**13.8**	**13.5**	**0.3**
1Yr	44.1	-3.2	-3.3	0.1	78.6	5.5	-0.5	5.9	40.7	-7.2	-6.2	-0.9

Source: FactSet, Lipper Analytical Services; FTSE Russell; Jefferies

Globally, markets also rallied. However, unlike in the U.S., where earnings continue to be additive, multiple expansion was the primary source of returns, with earnings on the decline. Not content to let Powell be alone, central banks around the world have renewed their emphasis on lower rates and quantitative easing.

Exhibit 6:
Sources of Global Equity Returns – 2019 Year-to-Date

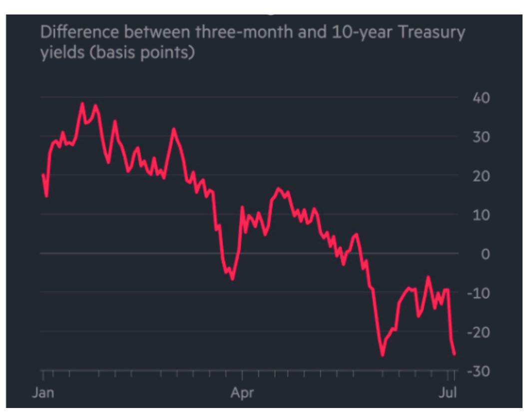


Source: JP Morgan

After appeasement failed, it took the bravery of men like my grandfather, who helped repel the Germans at the Battle of the Bulge, and those we celebrated in June on the 75th anniversary of the D-Day landing, to save the free world. Will appeasement by the Fed work this time? At present the market seems to think so.

However, we are reminded of our favorite WW II-themed novel, Catch-22. It's even a series on Hulu if you prefer just to watch. Seems to us Powell faces a classic catch-22. The economy is strong, but the yield curve is inverted, so he needs to cut short-term rates to keep it strong. But if he cuts short-term rates, it means the economy must be weak, so the curve will stay inverted even after a cut. That's some catch!

Exhibit 7:
Yield Curve Recession Signal Intensifies



Source: Bloomberg

PERFORMANCE REVIEW

After such an exuberant start to the quarter, small caps looked a bit overextended, but managed to repulse a May counterattack to end the quarter slightly higher. As for us, we kept pace in April, benefited from our bias toward quality and downside protection as we weathered the assault in May, then kept our momentum going in June despite an environment not favorable to our style. Once the dust settled, the Driehaus Small Cap Value Strategy was up 5.1% versus a 1.4% gain for the Russell 2000 Value Index. Over the last one-year, our strategy has gained 5.1% versus a 6.2% loss for the Russell 2000 Value Index.[1]

Our strong momentum from the first quarter continued in terms of our stock selection, which was positive in ten of the eleven sectors for the second quarter, with industrials the only negative. Sectors weights were a slight negative, due primarily to an overweight in consumer discretionary and an underweight in financials.

Exhibit 8:
Driehaus Small Cap Value Second Quarter Attribution Analysis

Attribution Analysis	Major Contributor	Major Detractor
Stock Selection	Information Technology	Industrials
	Consumer Discretionary	
	Health Care	
Overweights	Industrials	Consumer Discretionary
Underweights	Energy	Financials

Source: Driehaus and Bloomberg

Information technology, an area we have not had the occasion to discuss too often, was our best sector from a selection perspective. The top contributor in the entire portfolio was Computer Services Inc. Consumer discretionary was also strong, with good performance by Churchill Downs Inc. offsetting weakness in RCI Hospitality, which was sold during the quarter. The strong selection in consumer discretionary offset the deleterious effects of an overweight; the sector was a significant laggard in the benchmark.

[1]The performance data represents the strategy's composite of small cap value accounts managed by Driehaus Capital Management LLC (DCM) (the composite). These returns are estimated for the period as all underlying accounts have not yet been reconciled. All rates of return include reinvested dividends and other earnings. Net of fee returns reflect the payment of advisory fees and in some instances, other fees and expenses such as administrative and transfer fees while the gross of fee returns do not. Both are net of brokerage commissions charged to the accounts. The performance data shown above represents past performance and does not guarantee future results. Current performance may be lower or higher than the performance data quoted. The performance results for the composite are shown in comparison to an index. The index is not actively managed and does not reflect the deduction of any advisory or other fees and expenses. While the securities comprising the index are not identical to those in the composite, DCM believes this comparison may be useful in evaluating performance.

Health care, another place that often gets short shrift, was another positive contributor in terms of selection. There was not one standout name, but rather all four holdings held their own whereas the benchmark saw the sector decline over 5%.

While these were the top three sectors, energy and consumer staples were also helpful in terms of selection, as we posted gains in the two worst sectors in the index, each down over 8%. Our underweight in energy added a bit as well.

While our overweight helped, industrials detracted from performance. We generated a positive return in the sector but could not keep pace with the rally in the best sector in the index. A.O. Smith Corp was a laggard within the portfolio, which we sold as we became increasingly concerned about its non-U.S. exposure, which had shorts circling like sharks around the U.S.S. Indianapolis.

Exhibit 9:
Driehaus Small Cap Value Top Five Contributors and Bottom Five Detractors as of 6/30/2019

Top Five	Avg Weight (%)	Contrib (%)
Computer Services Inc	1.46	0.45
Churchill Downs Inc	1.37	0.35
KAR Auction Services Inc	1.41	0.32
NEWTEK Business Services Corp	1.65	0.29
AptarGroup Inc	1.59	0.26

Bottom Five	Avg Weight (%)	Contrib (%)
Murphy Oil Corp	0.66	-0.14
Limoneira Co	0.69	-0.15
BG Staffing Inc	0.92	-0.17
Smith (A.O.) Corp	0.78	-0.26
RCI Hospitality Holdings Inc	0.68	-0.27

Source: FactSet

The holdings presented do not represent all securities purchased and sold in the strategy over the quarter. Past performance does not guarantee future results. Performance calculation methodology for every holding in the strategy can be obtained by calling 1-888-636-8835.

POSITIONING AND OUTLOOK

Despite the recent Russell reconstitution, our relative sector positioning remained largely consistent versus the end of the first quarter. Industrials, consumer discretionary, and materials are the largest overweights, though we reduced the overweight in the former two during the quarter.

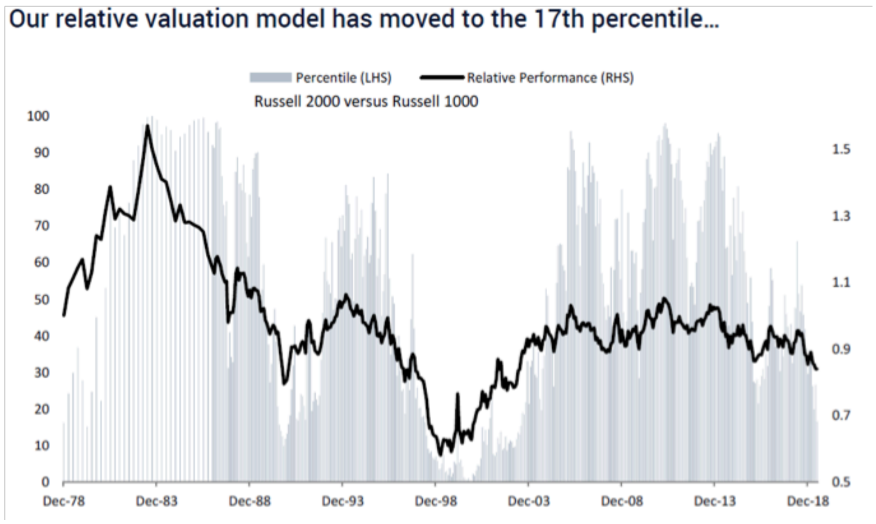
Information technology, utilities, and financials remained the biggest underweights. The magnitude of our underweight in utilities increased; valuations have become even more stretched as the sector has benefited from continuing declines in interest rates. Our underweight to financials, especially banks, increased because of the reconstitution, and we continue to be hard pressed to find companies in the industry that meet our yield plus growth threshold.

Energy and health care flipped from slight underweights to modest overweights by the end of the quarter. We repositioned in consumer staples, adding a name early in the quarter and selling another on valuation toward the end. Real estate investment trusts (REITs) and communication services were the only parts of the portfolio we did not touch during the second quarter.

Small cap managers feel a little like the Allies in early 1942; completely overrun, though in this case, it is large caps that have been the conquering force. What will be our Midway or Stalingrad? Perhaps something as simple as valuation.

While absolute valuations are high for both, according to Jefferies, small cap is in the cheapest quintile versus large cap, which historically has boded well for small caps.

Exhibit 10:
Relative Valuations Russell 2000 versus Russell 1000



Note: Relative valuation model consists of relative Trailing and Forward P/E, Price to Book, Price To Sales and from 2002 Price to Cash Flow; from March 31, 2016 forward Jefferies' estimates
Source: FactSet; FTSE Russell; Jefferies

	Subsequent Relative Performance			**Batting Average***		
Valuation Quintile	**3 Months**	**6 Months**	**12 Months**	**3 Months**	**6 Months**	**12 Months**
1 (Cheapest)	**1.2**	**2.8**	**6.1**	**60.7**	**69.0**	**77.4**
2	1.3	1.2	1.1	58.5	62.0	62.8
3	0.0	0.1	-0.6	47.1	52.9	55.0
4	-1.3	-1.4	-2.3	34.5	39.3	35.7
5 (Most Expensive)	-1.6	-3.4	-5.2	27.4	15.5	10.7
Russell 2000	**-0.1**	**-0.2**	**-0.2**	**45.6**	**47.6**	**48.0**

Note: Batting average represents percent of times small beat large
Source: FactSet; FTSE Russell; Jefferies

We remain vigilant and continue to work to manage risk against a backdrop where investors are caught in the crossfire of weakening macro data and central bank easing, all at a time of high absolute valuations for U.S. stocks. If weaker macro takes the day and returns are lower or muted, we believe our emphasis on dividend yield as a meaningful component of total return and the downside protection of dividend payers positions us well; if central bank easing provides a boost higher, we believe the growth potential of the portfolio will help us keep pace. So far this year, that is what we have seen, though it is far too early to declare victory yet.

Source: Getty Images

PERFORMANCE[1] as of 6/30/19

				Annualized Total Return			
	QTR	**YTD**	**1 Year**	**3 Year**	**5 Year**	**10 Year**	**Inception 8/1/13**
Driehaus Small Cap Value Composite (Gross)	**5.25%**	**18.09%**	**5.70%**	**12.92%**	**10.39%**	----	**11.62%**
Driehaus Small Cap Value Composite (Net)	**5.10%**	**17.81%**	**5.13%**	**12.41%**	**9.93%**	----	**11.20%**
Russell 2000 Value Index	1.38%	13.47%	-6.24%	9.81%	5.39%	----	7.05%
Russell 2000 Index	2.10%	16.98%	-3.31%	12.30%	7.06%	----	8.56%

Data as of 6/30/19. Preliminary performance data. In US dollars.

Sources: Driehaus Capital Management LLC, Factset Research Systems, Inc., eVestment Alliance
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[1]Performance presented occurred while members of the portfolio management team were affiliated with Opus Capital Management ("Opus"). Such members of the portfolio management team were responsible for investment management decisions for the Opus Small Cap Value Plus Composite, renamed as of May 1, 2019, Driehaus Small Cap Value Composite. The decision making process has remained intact and independent within DCM. The performance presented is for those portfolios that were brought over to DCM from Opus.
Per FactSet Research Systems Inc., the attribution report provides an in-depth analysis of relative performance. With this report one can research whether or not a portfolio outperformed a benchmark, and how each group contributed to performance. The performance data shown above is estimated and represents past performance and does not guarantee future results. Current performance may be lower or higher than the performance data quoted. The information presented is intended for informational purposes only.

PORTFOLIO CHARACTERISTICS[2]

	Strategy	R2KV	R2K
Number of Holdings	84	1,347	1,977
Price-to-Earnings[2]	16.2	13.7	15.5
Dividend Yield (%)	3.2	2.2	1.4
Return on Equity (%)	16.0	6.3	6.0
Debt to Total Capital (%)	40.3	40.3	37.3
Weighted Avg. Mkt. Cap ($)	3,599.4	2,185.9	2,571.3

SECTOR WEIGHTS

Month-End Absolute Weights (%)

	Comm. Services	Consumer Discretionary	Consumer Staples	Energy	Financials	Health Care	Industrials	Information Technology	Materials	Real Estate	Utilities	Cash
Strategy	0.9	12.9	0.8	6.0	25.0	5.2	18.5	6.8	7.4	10.6	4.3	1.6
R2KV	2.9	8.5	2.4	5.1	29.4	4.0	11.6	11.9	4.2	12.3	7.6	0.0
R2K	3.0	11.7	2.7	3.3	17.6	15.9	15.2	15.4	3.8	7.5	3.9	0.0

TOP 5 HOLDINGS[1] (as of 6/30/19)

Company	% of Strategy
Aptargroup, Inc.	1.7
Newtek Business Services Corp.	1.6
Main Street Capital Corporation	1.6
Algonquin Power & Utilities Corp.	1.6
Hexcel Corporation	1.5

Sources: Driehaus Capital Management LLC, Factset Research Systems, Inc., eVestment Alliance
Data as of 6/30/19. Benchmark: Russell 2000® Value Index
[1]Holdings subject to change.
[2]Trailing 12-months, excludes negative values.

Driehaus Capital Management LLC (DCM) is a registered investment adviser with the United States Securities and Exchange Commission (SEC). DCM provides investment advisory services using growth equity strategies to individuals, organizations, and institutions. The firm consists of all accounts managed by DCM (the Company). Prior to October 1, 2006, the firm included all accounts for which Driehaus Capital Management (USVI) LLC (DCM USVI) acted as investment adviser. On September 29, 2006, DCM USVI ceased conducting its investment advisory business and withdrew its registration as a registered investment adviser with the SEC. Effective September 30, 2006, DCM USVI retained DCM as investment adviser to these portfolios.

DCM claims compliance with the Global Investment Performance Standards (GIPS®).

COMPOSITE OBJECTIVE

The strategy began August 1, 2013 and includes portfolios that seek capital appreciation through the investment in U.S equity securities with above average dividend yields that are fundamentally undervalued, financially strong, and exhibit strong earnings growth and positive earnings momentum. The accounts will invest primarily in small capitalization U.S equity securities, as defined by the market capitalization ranges of generally followed small cap indices at the time of purchase. They may also invest, to a lesser extent, in mid capitalization stocks from time to time. The resultant portfolios will generally be fully invested and diversified by sector and security.

PERFORMANCE

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Prior to May 1, 2019, monthly composite returns were calculated using the aggregate return method where all the composite assets and external cashflows are combined as if the composite were one portfolio. Time-weighted account rates of returns were calculated on a monthly basis and allowed for the effect of cash additions and withdrawals using the Modified-Dietz method. Portfolios were revalued for any cashflows in excess of 1% of the market value and at the composite level at 1% of the market value at the beginning of the month. A significant cashflow policy was also employed defined as a cash flow or aggregate of a number of cashflows within a calendar month that exceeds 35% of the market value of the composite at the beginning of the month. Any accounts exceeding this threshold were excluded from the composite during the month it occurred.

From May 1, 2019, monthly composite returns are calculated as the sum of the monthly returns of each account weighted by the account's beginning monthly value as compared to the Composite total. Account rates of return are calculated on a monthly basis by geometrically linking daily returns. Monthly composite returns are geometrically linked to determine annual composite returns.

Net of fee returns reflect the payment of investment advisory fees, custodial and trading expenses while the gross of fee returns do not. The annualized rate of return is presented as the level annual rate which if earned for each year in a multiple-year period, would produce the actual cumulative rate of return over that period.

Returns are computed and stated in US dollars. Leverage is not part of the investment strategy of this composite.

Additional information regarding policies for valuing portfolios, calculating and preparing compliant composite presentations are available on request. A complete listing and description of all composites is also available upon request. Please contact our sales, marketing and relationship management departments at 312-932-8621.

INDICES

The Russell 2000 Value Index (RK2V) measures the performance of the small-cap value segment of the U.S. equity universe. It includes those Russell 2000 companies with lower price to book ratios and lower forecasted growth values.

The Russell 2000 Index (RK2) is an index measuring the performance of approximately 2,000 smallest-cap American companies in the Russell 3000 Index, which is made up of 3,000 of the largest U.S. stocks.